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FUNDAMENTAL FACTORS IN WAR FINANCE

The first flurry of discussion of war finance which accompanied American entrance into the conflict has now (September, 1917) subsided. But the critical importance of the issues involved promises to grow with the progressively increasing share of the burdens which the United States will have to assume as long as the policy of Allied victory and a dictated peace is adhered to. The present is therefore an opportune time to broadly reconsider these issues and to summarize the conclusions to which an attentive student of past discussion has been led.

I

Superficially war is paid for with money, but in reality it is fought with vast quantities of goods. What, then, are the physical sources from which these goods may be derived?

First, and least of all under present conditions, may be mentioned future income to be produced after the war, in so far as American claims to it are sold or mortgaged to neutral countries in exchange for abnormally large portions of their present income. But as the power of countries still neutral to lend such goods for future payment is very limited, this source may be dismissed as of very minor consequence.

Likewise past income might in a sense be drawn upon, if taxation were so severe as to allow neither a return to the ownership of capital goods nor sufficient funds to offset their depreciation. But such taxation would doubtless not be feasible, nor has it been proposed by the most "radical" of counselors. Hence this resort is altogether negligible.

The really important sources therefore are those of *present production*, which are available through several different channels, briefly: (1) the diversion of present energies to unwonted tasks, (2) the intensifying of the average worker's productive effort, and (3) the elimination of waste effort.

There are two sorts of effort which may be diverted to war purposes: (*a*) the creation of machines and other "instruments of production," which for all non-military purposes has now virtually been stopped in England; and (*b*) the operation of such existing "capital goods" as produce nonessential "consumers goods." Examples of the latter are alcoholic liquors, fine clothing, more or less ornamental public works and magnificent churches. Or, again, (3) some effort may be liberated by substituting less costly articles of "necessary" consumption for others, e.g., by replacing meat largely with rice as an important article of food.

The value of such abstinences depends, of course, on the extent to which the energies freed may be applied to war purposes. Much of our existing stock of capital cannot be so applied because (like breweries) it is not adapted to alternative uses, although the machinery in our vast array of automobile factories is notably convertible. But our supply of laborers and managers is highly "mobile" as to place, and considerably "mobile" as to occupation, especially if organization is provided to facilitate the transference to war tasks. And such organization is highly essential to realizing any great part of the possibilities of individual transformation.

Of course this method must involve considerable loss and inconvenience to those now in the nonessential industries, like the milliners and the silk producers, who began at an early date to agitate against curtailment of the demand for their goods. It involves (*a*) loss of rewards formerly received for special skill or knowledge not usable in alternative war occupations, (*b*) loss of the

yield of idle machinery, and (*c*) losses due to the enforcement of long-time contracts for unusable materials, unless such enforcement is waived during the war by the sellers or excused by law, as it should be. And these private losses are inevitable, if there is to be any genuine and speedy "mobilization" of the dispensable energies of the country.

We cannot have that and have "business as usual," for which men of affairs like Mr. Howard Coffin, and organizations like the Rotary Clubs, put in an early plea. "Business as usual" offers at best only the profits from unnecessary consumption as aid to the government, which some critics seem to think it must receive through such channels if at all. They forget that to stop that consumption may *afford nearly the whole fund* otherwise so expended.

As already stated, this stoppage means reduced rewards for some, notably for "promoters" and for those among the more skilled workers whose special functions are temporarily not in demand. But it does *not mean unemployment* so much as changed employment. If the work on skyscrapers lags (as it should), the work on an emergency fleet booms, the restricted building of pleasure cars is compensated by the increased construction of trucks and tractors, those who can't find work upon civilian clothing will find it in making army uniforms, and so on. True, this demands accommodation on the part of the worker, but nothing like what going to war demands of the soldier.

The extent of resources which could be made available, if all unnecessary consumption and all private investment could be shut off without any lag in industry, may be seen from the estimate of Dr. Eliot that our annual expenditure for "luxuries," such as liquor and tobacco, automobiles, candy and chewing gum, amounts to 5.3 billion dollars, and from the National City Bank's computation[1] that our new capital investment in the recent past has averaged at least six billion dollars and probably considerably more than that. Twelve billions is doubtless a conservative estimate of the two items together, at the prices prevailing in 1914.

The third source of war aid mentioned is intensification of effort. The writer regards this as less important than the first, for

[1] Cf. *Economic Circular*, May, 1917.

the reasons that industry is already highly speeded up, owing to the abnormal demands of the past three years, and that the withdrawal of a million or more men for military service will largely offset whatever influx of women into industry there may be.

The fourth source, elimination of waste in productive processes, seems to offer larger possibilities. It might be more easily applied in distributive lines than in productive lines—England now has purchase and sale of staples like sugar and cotton by government war monopolies which save all the lost motion of competitive methods. Owing to the inertia of customary habits, "scientific management" is more difficult to introduce widely in factory processes, but it likewise (together with a system of labor clearing-houses) contains vast possibilities of saving and utilizing effort. However, government monopolies or "scientific management" in private industry require either such elaborate administrative machinery or such a break with past practices that these "sources" will receive only minor notice here, not because they are unimportant, but because they are less immediately available and less directly connected with the theme of finance as traditionally defined.

These, then, are the main "sinews of war": reduced consumption, reduced capital investment, intensified effort, and diminished waste effort. And, to repeat, they are all *present sources.* For, except for negligible borrowings from foreigners, our own citizens must *pay now* out of current income whatever the government spends now, and, taking the nation as a whole, it is *simply impossible for "posterity to share the burdens"* (although posterity must of course suffer hardships due to the inevitable shrinkage in the supply of new capital goods).

The government may indeed promise certain contributors repayment "out of future production." But this "burden on posterity" *is paid to posterity* and is therefore not a burden at all to the future nation as a whole. Hence from the community standpoint, if we assume the various plans of finance to be equally effective in diverting supplies now for government use, the distribution of burdens in terms of wealth as between present and future is the *same in any event.* The case is different, however, as regards burdensomeness to individuals, as will hereafter be shown.

II

The various methods of war finance may be briefly classified as voluntary or coercive, according as those who in the last analysis surrender the goods do so freely consenting or not. The term "borrowing" covers, of course, all the expedients under the first head, whether the debt be represented by a short-term "note" or by a longer-term "bond." But, if carried beyond certain limits, "borrowing" may also involve coercion, as will presently appear.

The coercive methods are more numerous. The more elaborate forms which involve the control of maximum prices may affect: (*a*) goods purchased directly by both the government and its own citizens or (*b*) goods monopolized by the government for resale with or without profit—usually with profit. The simpler forms which only indirectly (if at all) affect prices are: (*a*) taxation, (*b*) the issuance of legal tender notes ("fiat money"), debasement of the coinage, and (*c*) such bank loans directly or indirectly to the government as result in a net expansion of the sum total of bank loans. As these simpler methods seem more readily adapted to "democratic" use and have figured more in recent discussions, attention here will be paid chiefly to them.

All these latter methods are calculated, of course, to increase the government's share of purchasing power, either without increasing the number of monetary "counters" (in the case of taxation) or by increasing that monetary fund (in the other cases). And at the same time the general level of prices rises. But, whereas under taxation this is due primarily to a gradual shrinkage in the supply of labor and of new capital and to the centering of demand upon fewer classes of expenditure, the tendency is *accentuated* in the other cases by the mere increase in the number of "counters" competitively offered for goods, without any corresponding increase in the supply of goods themselves.[1]

But is it necessary that the borrowing policy should result in a net increase of bank loans and of deposit circulation, based thereon? It is not inevitable, but that is what almost invariably happens. And this for two reasons: first, the government does not offer an interest rate high enough to get all needed funds from individuals

[1] Cf. *London Economist*, October 21, 1916.

by transfers from their existing bank accounts to its own; and, secondly, to make up the deficiency the banks do not diminish their existing loans to individuals as much as they increase their loans to the government, directly or through intermediaries who borrow of them for that purpose.

It may be urged, however, that a bank's first concern is to keep its deposit liabilities down to a certain multiple of that portion of its assets defined as "reserve"; that self-interest will prompt it to loan exclusively for "business" purposes, as long as "business" rates continue higher than the government rate; and that, whenever the two rates are equalized, the reserve will be protected by denying "business" to the same extent that the government is accommodated.

But this argument errs in assuming that the multiple of reserves considered safe by bankers does not vary (under given business conditions) according to the *composition of their assets* and that maximum interest rates alone determine those assets. The truth seems to be rather that the safety of government bonds prompts banks not only to loan above what would otherwise be their "normal" multiple of reserves, but to do so at rates lower than those to ordinary borrowers. Especially is this true when the government rate is $3\frac{1}{2}$ per cent or more, tax-free, instead of $1\frac{1}{2}$–2 per cent net, as in former years, and when motives of patriotism and of deference to outside "pressure" are added to the motive of self-interest.

But the mere stretching of reserve multiples is not the only means of expanding loans in countries, like our own, where the government has been keeping gold in its own vaults. For the mere transfer of this gold to bank vaults, with the tacit understanding that it is to be used to "help the government," instantly swells those basic reserves themselves.[1]

But whatever may be the motives of this complex procedure, the result is well illustrated by the course of events in England where, although the reserve of the Bank of England gained in absolute amount over 50 per cent in the first two and one-half years since the war began, in the same period its ratio to demand liabilities fell from 40.3 per cent to 18.5 per cent. Of the $14,000,000,000

[1] Cf. *New York Times Annalist*, July 10, 1916.

which England borrowed in that period, approximately $2,000,000,000 appears to have come from the expansion of bank loans,[1] about half of which were made directly by the banks, and the other half indirectly through private borrower-lenders.[2]

The result of course is an unprecedented rise in general price levels. And for whose benefit? Certainly not the government's, because it loses vastly more in price increases than it saves in interest charges, nor does it recover more than a fraction of these losses in excess-profit taxes. Certainly not the wage-workers', because, as Sidney Webb states, while money wages in England have gone up 20–25 per cent, prices have increased much more, and thus commodity wages have fallen.[3] But the people hardest hit are those living on fixed money incomes or having investments in enterprises like public utilities, whose rates are legally fixed while their operating costs rapidly advance. Little sympathy will be wasted in war time upon the more well-to-do so "hit," but perhaps the smaller fry, the beneficiaries of small life insurance policies and other "widows and orphans," do not deserve such treatment.

Who, then, does gain what the government and these other classes lose? Presumably the bulk of it is absorbed by the banks as interest upon an abnormal volume of loans,[4] by manufacturers of war specialties, and, most of all, by extractors of raw materials, such as farmers and the producers of coal, copper, and iron ore.

If the government also benefited by this virtual taxation of the many for the benefit of the few, it might be considered a shrewd political trick of shifting to the business man the odium incident to a state gain. But since the government commands no more funds than it might get by paying higher interest and by forbidding the banks to increase radically the net volume of their loans, and since it actually loses by the failure to do so, its policy must be charged to sheer fiscal stupidity—that and nothing else. The

[1] Of the liabilities thus created, about $480,000,000 issued from May, 1915, to November, 1916, were represented by "treasury notes" issued through the banks (*Econ. Journal*, December, 1916, p. 436).

[2] National City Bank, *Economic Circular*, March, 1917.

[3] Cf. *Atlantic Monthly*, July, 1917, p. 19.

[4] Cf. *London Economist*, October 28, 1916.

issuance of a volume of fiat money equal to the amount of loan expansion would have no more serious effect upon prices and would at least "save" considerable interest. Of course this is not an argument for fiat money.

The tax policy, on the other hand, avoids any such expansion by *avoiding the occasion* for it. It might, indeed, make as heavy demands upon the masses. But whatever levies it made would be "open and aboveboard" and would not promote "profiteering" at a time when that is least defensible. It would, indeed, put more of the ultimate burden on the wealthy than does the bond policy, even if that did not give rise to price-raising. For the normal surplus of income over the cost of necessities is for the poor and the middle class quite limited in any one year and quite inadequate, during the period of a war, to the governmental needs of that period. Under either policy the huge remainder must be obtained from the wealthy; but the loan method permits them to recover a considerable portion of their present contribution out of taxes on other classes spread over a longer time and therefore more "productive."

And this is the only advantage to the wealthy in the bond policy as against present taxation. For if it were certain that the various classes were to bear the same shares of the total burden under either method, then there would be *virtually no choice* between the two for any of them. Bondholders would then merely take out of one pocket in taxes as much as they put back into the other pocket in interest and repaid principal. But in actual practice bonds are quite likely to mean, as Professor Davenport remarks, "a mortgage of the masses to the classes." A mortgage payable in instalments is for the former preferable, of course, to starvation taxes at one stroke. Whether they should be subjected to either is a different question which will be considered presently.

III

Our next concern is with the various criteria of choice between taxes and loans as predominating elements in the financial plan. These are conveniently brought out in a review of objections made to the taxing method.

Perhaps the most time-honored of these is the plea that the tax plan would break all historic precedent. Past practice has always favored loans and even today England raises but 17 per cent of war expense from the proceeds of new taxes (fiscal year 1916–17).[1] Unfortunately, the past is often as illustrious for its blunders as for its proverbial wisdom. So, while custom is not to be flouted gratuitously, neither is it any bar to practices suggested by constructive imagination as the better alternative.

A second minor objection is that "excessive taxes on incomes will deplete the surplus available for investments" in government bonds. The same thing might be said of any income tax whatever as well as of most other forms of tax. But the obverse of this statement would be equally forceful—government bond investments deplete the funds available for taxation. Both statements of the single fact are equally irrelevant.

Again it is urged, notably in Congressional debates, that posterity will share the "benefits" of this war and should therefore share the burdens. It has already been shown that, if we consider the nation as a whole, posterity cannot possibly share the burdens. And unless the future peace is based upon the overthrow of the Teutonic dynasties and the expropriation of their supporting classes, upon international free trade and international control (not merely restriction) of armaments and regulation of the exploiting of "backward" countries, and upon adjustments of boundaries and of reparative payments which shall not embitter the Teuton masses, its "benefits" may not last over fifteen years and may be only the prelude to another world-war. That is certainly doubtful warrant for "deferring burdens," even if the argument were otherwise sound.

Another objection, more familiar in the criticisms of economists (notably Professors H. C. Adams and Bullock),[2] concerns the merits of taxation, not after the first year or two of war but during that transition period. This is the "dislocation" argument, the gist of

[1] E. R. A. Seligman in *New York Times*, May 31, 1917.

[2] Henry C. Adams, "Financial Management of a War," *War Finance Primer of the National Bank of Commerce*, p. 55; Charles J. Bullock, *Quarterly Journal of Economics*, May, 1917, pp. 367, 379.

which is not that the tax method causes a more rapid and complete shift from peaceful to warlike activities (although that may be an undisclosed truth), but that in this shifting process it is more disturbing to those who have *already pledged future income* to certain purposes. It is alleged that taxation thwarts more hopes and forces more abandonment of contracts—the "psychic burden" is the point emphasized.

Upon what assumptions, however, will the bond plan be acceptable from the standpoint of war efficiency? On condition, first, that the great bulk of committed income is pledged to industries vital to military support, and, secondly, that the owners of uncommitted income will actually invest in the desired volume of government bonds. But there is no evidence for either of these propositions. The bond plan may allow an undesirable investment of both committed and uncommitted future income in nonessential industries to the detriment of war preparations.

And furthermore, the difference between the plans in disturbing effect is not what it seems at first blush. For the optional cancellation of pre-existing contracts affected by war conditions might be made a legal part of the tax plan, in which case the "inconvenience" would be thrown back upon producers of goods in the less specialized forms better adapted to alternative uses and therefore disposable as a rule under new contracts. And again, in so far as the bond plan inflates prices, it "disturbs the calculations" of the fixed-income classes by lessening either their consumption or customary savings or both. It also disturbs any commitments based upon anticipated control over popular savings which unexpectedly shrink as a result of inflation. Therefore "dislocation" neither is a prime concern to the public financier nor is it necessarily any more of an evil in the tax plan than in the bond method.

Another argument quite akin to the foregoing is stated thus by Professor Seligman: "The pay-as-you-go policy . . . . puts a *crushing burden* upon the taxpayers in the particular year when the [extraordinary expenditure] is made,"[1] whereas, according to Professor Adams, "When a government gives bonds in return for capital, the individual who supplies the capital does *not feel the sense*

[1] Cf. citation above.

of personal loss which attends the payment of a tax. He has merely changed the form of his property."[1] That is to say, *he does not feel the loss now.* And by inference the whole nation has no such feeling of immediate burden as it otherwise would have.

On what assumption will this be true? If the future distribution of bond-canceling taxes were known in advance, it would be true only on condition that those slated to bear the brunt in future could not now feel that sense of sacrifice which those who have the means and must necessarily pay the present cost would now feel if they expected no repayment out of taxes levied on other classes. For if bondholders expected virtually to have to take out of one pocket in taxes as much as they would put back into the other pocket as interest and repaid principal, then bonds would lose their charm to all who are at least moderately rational.

In practice, however, the future apportionment of debt-canceling taxes is not usually foreknown (except as to tax-exempt provisions when inserted in bonds). Here, then, the conditions under which the argument would hold are, first, that the rational element among the bondholders should expect other classes to pay the bulk of the debt to them; secondly, that the rational element among these other classes should not expect to do so; and, thirdly, that the irrational element who must otherwise be hit by present taxation are very numerous. This last condition is doubtless quite unreal because the rich and well-to-do, from whose incomes war taxes could chiefly be drawn, if it were so desired, probably number an exceptionally high percentage of forethoughtful individuals.

As for the other two conditions, the fact is that war bonds usually mean, in the words of Professor Davenport already cited, "a mortgage of the masses to the classes"—and, to a much lesser extent, to themselves. All the small bondholders hoping for a net reimbursement are therefore deceived, although no more so than the rational element among the non-bondholders who expect to escape reimbursing the large bondholders, if any of them really do so expect. In so far as the masses (whether bondholders or not) fail to visualize the future, they are soothed only by an ignorance which it is not very exalted policy to exploit. And to forethoughtful

[1] Cf. citation above.

bondholders the bond method offers no solace *unless it either* (1) *tacitly deceives them*, *or* (2) *promises them future benefits at others' expense.*

Whatever added mental comfort the bond plan secures is therefore discredited by the price paid for it. Nor is it an uncompensated gain *even in the present.* For in so far as the bond plan hits the small fry among the fixed-income classes by expanding bank loans and inflating prices, their intense privation is an important offset to the soothing of bondholders.

And if in the "calculus of utilities" the net result may be termed a gain, it is that *only temporarily* and not for the whole period over which bond extinguishment is spread. For, as time drags on, the shortsighted and deceived classes of taxpayers undergo compensating hardships, which under the usual conditions are often of an intense sort, because of the meagerness of many incomes so drawn upon.

Therefore the "reduced-burden" argument for bonds not only presupposes deception, but, whatever unimportant truth it may contain, is valid only as regards a limited time or a given class of people (notably the rich and well-to-do) and not as regards the whole time and number of people affected by war financing. For which reasons the argument is quite inconclusive.

However, the first consideration to most economists and business men nowadays is the growth of the supply of capital goods, and to such of them as criticize the "pay-as-you-go" plan on this score that criticism is the weightiest objection.

There are two minor variations on this theme, of which the first is the familiar argument recently voiced by Mr. Otto Kahn, that the taxing method would cause "expatriation of capital." This claim refers, of course, to the current flow of income, past accumulations being already invested in forms which cannot as a rule be exported. And its weakness lies in the facts: (1) that, even if they expatriated themselves, owners might be made to pay taxes here upon that flow when first received as "income" from this country; (2) that self-expatriation and removal from the United States would be necessary, in order to escape taxes here on returns from foreign investments; and (3) that, whatever foreign tax rates may be

today, there was never more uncertainty as to what they will be tomorrow or the day after.

The second minor objection is that heavy taxation would cause "capital to go into hiding." If this refers to failures to report current income, the difficulty may be largely obviated by administrative efficiency, and the country will not be poorer anyway for the income successfully concealed. If it refers to refusals to reinvest income, the obvious reply is that it would be less profitable to bury one's talent and to get no returns from it than to invest and get a positive return, however diminished temporarily by taxation.

The major objection, however, is that the "pay-as-you-go" policy would *impair the incentive to effort* more than the bond plan—presumably this is what is implied in Professor Seligman's statements that "to abandon the use of credit is to revert to primitive economic conditions and to lessen social productivity" and that ". . . . the tax-only policy would require more than the total surplus of social income,"[1] for there is no other explanation for either. Now there are several reasons for doubting that theory.

In the first place, if we assume that considerations of gain are the chief motive in war as well as in peace, it may be that current taxation would force an *economizing rather than a relaxation* of effort, i.e., through the adoption of "scientific management" in private production—this being relatively easy in times when, as now, the demand for labor is greatest.

Secondly, the effect upon incentive depends largely upon the *kind* of tax chosen. Comprehensive taxes on competitive production may perhaps be a serious deterrent, if there is no escape through greater efficiency. But not so with rapidly progressive income taxes, taking very great portions of the upper ranges of large incomes, provided the rates be graduated so as to leave the recipient substantial (although diminishing) remainders from each successive portion of his income. The possibilities of such a non-relaxing form of tax have doubtless never been more than "scratched" hitherto.

[1] Cf. *New York Times*, May 31, 1917.

And finally, there is an added sustainer of effort in war which peace times do not commonly afford, namely, patriotism. Of course the sacrifices which this may prompt are limited by the elementary requirements of life, and therefore the wealthy may do more from this motive than other classes can. Their professions recently have been positive and no doubt sincere. There is therefore no reason to expect them to be "slackers" under very heavy taxes in war time, even assuming that scientific tax forms would so prompt them in ordinary times. In so far as taxes are a deterrent at all, that fact is a caution against leaving a legacy of debt to be paid off in normal times, when the motive of patriotism is absent, rather than against severe taxation in war time.

From the standpoint of industrial stimulus, then, it may well be that the "pay-as-you-go" method is preferable to its alternative in the retrospect of times after the war and is equally desirable meanwhile. But a second factor bearing upon the capital goods supply is fully as important, namely, the volume of *private consumption.*

On this score a very ingenious theory has been advanced by the National City Bank of New York, which, because of the bank's influence in certain quarters, deserves detailed examination. Under the heading "Savers and Spenders" the bank divides society into two groups, the majority among both rich and poor who spend all they get under whatever conditions and the minority, likewise scattered among all social classes, who save, and the argument runs tacitly as follows:[1]

The standard of living of the savers is rigidly fixed, for, as the bank states elsewhere, "under no conceivable circumstances will taxation encroach upon the portion of [their] income which is devoted to [their] own support."[2] But the standard of the spenders (including by inference a majority of men of enterprise) is quite flexible and may be substantially reduced by taxation even in peace times *without relaxing* their will to work (otherwise the forthcoming conclusion as to a net capital gain might not hold). Therefore, says the bank, all taxes upon the savers represent a loss to the capital fund unless returned to them in the guise of interest and principal

[1] Cf. *Economic Circular*, May, 1917.

[2] *Ibid.*, June, 1917.

on money received from them as loans. And all taxes on spenders represent a gain to the capital fund by furnishing means toward repaying the savers as bondholders.

So far so good, but the conclusion does not go far enough. For the rest of it is this: the more that spenders' waste is shut off now by taxation, the *less funds must the savers supply* now (whether as taxes or loans or both) to meet a given government expenditure. *Thus all savers' contributions whatever represent a loss* in capital, at least a temporary loss and an unnecessary one, in so far as the funds might have been obtained from the current income of spenders instead.

From the capitalistic standpoint the ideal policy would therefore be to tax spenders "to the bone" and let savers go free or only borrow from them. But the bank would concede that to be impracticable and doubtless too severe a case of "taxing for social purposes," which financiers usually frown upon.

The next-best arrangement would be to tax both spenders and savers "to the bone." By putting the maximum present burden on spenders, that would make the minimum demand on savers. True, the latter would pay more taxes than under the bond plan, *but less in taxes and loans combined;* and to that extent they would have more for private investment. But, since by admission the spenders include a majority in all income classes, this result could be achieved only *by combining heavy income taxes* with whatever consumption taxes were thought tolerable.

The bank, however, favors relying chiefly on consumption taxes and loans, which would deplete the current capital supply by every dollar of the larger spendthrifts' income allowed to go to waste. Would this loss be more than made good after the war? Not unless the spenders were to pay a larger fraction of the long series of taxes out of which war bonds were canceled than they would pay of the shorter-lived and more severe taxes under the "pay-as-you-go" plan. But that is contrary again to the assumption that spenders form a majority of every income class. Therefore on its own hypotheses the bank's plan would no more than tardily make good after the war that unnecessary present loss of capital which it would entail.

And furthermore, it would make it good *more largely out of humble spenders* than under the alternative plan. "Paying as you go" would put a more effective stop to spendings on jewels and art, grand opera and cabaret, pleasure automobiles and power boats, palatial residences and hotel accommodations, winter vacations in California and at Palm Beach, valets, footmen, and the hundred other functionaries of ornamental personal service. Whereas the bank's program would for a much longer time shut off a narrower range of expenditures on dispensable articles of food and drink, cheap amusements, cheap ornaments, and other "luxuries" of the masses.

The chief objection, however, is not to the bank's failure to perceive all the conclusions latent in its premises, but to the invalidity of those premises themselves. In the first place, there is no warrant for assuming that taxation in peace times will not relax effort and so retard the labor and managerial sources of new capital. And secondly, the inflexible standard of living attributed to all savers is doubtless true only of an insignificant number within that group. It cannot be said that the net amount of bond payments made to the great majority of them in future will not increase their spendings and so will all be "restored . . . . to the capital fund," or that current taxes will not reduce their war-time consumption at all.

The truth seems rather to be that the consumption of everyone is elastic, but that the different fiscal methods are not equally successful, as Professor Sprague has so forcefully urged, in bringing home the need for thrift. If buyers of government bonds realized the physical unproductiveness of the investment and also expected future taxes to make it financially valueless to them, then self-interest or patriotism or both might move them to economize as much as severe taxation would. But the very thing that makes the bond plan seem less "burdensome" during war is also the foe to economy, namely that ignorance of or hope of escaping future tax burdens to which reference has already been made.

The superiority of the tax plan in checking consumption therefore seems incontestable. Even if we assume this to be wholly offset by its alleged effect in relaxing effort, the result would be no less favorable to the capital supply than under the bond plan, either

at the end of the war or in after years. But in so far as patriotism is a war-time substitute for gain as a motive and as certain forms of tax are not deterrents anyway, these factors make for better *immediate conservation* of capital under the "pay-as-you-go" plan—a conservation, moreover, without such extreme hardships to the small fry among the fixed-income classes as result whenever price increases follow in the train of inflated bank loans under the bond method. So much for "the goose that lays the golden egg."

A final objection is that taxation "dries up the sources of charity and educational endowment" more than borrowing does. The extent to which this is true depends, of course, on whether benefactions are exempted in the income-tax law—philanthropists will naturally give away more untaxed than taxed income.

But if we admit that the claim is true as to private sources, what of it? "A man having a national reputation in civic work states that the number of very wealthy who systematically support reform or charitable movements is probably *not more than 5 per cent* of the total of that class."[1] Therefore if there is no exemption of gifts in the law and if all incomes are only moderately taxed in order to spare the 5 per cent, then the 95 per cent are encouraged in wasteful consumption and either the capital supply or the popular consumption of "necessities" suffers, or both do.

The tax policy, on the other hand, if it temporarily cuts down the gifts of the charitable, *also provides the means for public subsidies* to indispensable agencies (like the Red Cross) out of taxes on both the charitable and the uncharitable. All that severe taxation necessarily "dries up" is the self-gratulation of benefactors. If it also cuts down luxurious consumption and nonessential charities, that is just what furthers the supreme end in war time.

IV

For the foregoing reasons the taxing policy seems preferable from the standpoint of the economic and cultural interests of a nation as a whole rather than of small groups thereof. But in the present instance the administrative machinery hitherto sufficient for peace needs would not be immediately adequate for the demands

[1] *Equity* (Philadelphia), July, 1917, p. 134.

of multiplied war taxation. For this reason alone a resort to bonds is necessary as an emergency measure.

For how long should such bonds run? And, which is a more important question: should these obligations be exempt from tax or not? Unless exemption secures some peculiar benefit to the government and better conserves the capital supply, the presumption is against it.

On behalf of exemption it is urged that that policy makes it easier to secure the desired volume of public loans. That is quite untrue. Ease of flotation depends simply on the interest rates offered in the respective cases, and a given volume of non-exempt bonds will sell as readily as if they were exempt, provided the difference in rate is sufficient.

It is urged, however, that exemption yields some net saving in interest costs to the government. Now if all lenders were subject to the same rate of income tax, that claim would manifestly conflict with the whole theory of capitalization, which holds in brief that the allowance of any future tax immunities is compensated by the beneficiary's payment in a lump sum of the "present worth" of such advantages, *in so far as they are assured at the time of bond purchase, and no more.* Suppose, for example, that the proposed issue of war bonds could be floated non-exempt at a price yielding the investor a *gross* interest return of 3.6 per cent before deducting taxes. Suppose also a flat income-tax rate of 3 per cent on all investors' incomes. This would mean an annual deduction of about $\frac{1}{33}$ of their interest receipts or .1 per cent of the principal, leaving 3.5 per cent as their *net* interest return. It would, then, be immaterial to them whether they paid a price yielding 3.6 per cent gross interest or, if the bonds were exempt, paid a higher price yielding 3.5 per cent net interest, and for the same reason it would be immaterial to the government.

Unfortunately for our calculations, the case is not so simple as that, because bond-purchasers will include investors paying all the way from no income tax at all up to a considerable portion of the higher ranges of individual income. And moreover, the supertax rate is not the same for all portions of a given income, but increases for the successive portions as the income itself increases in size.

Tax exemption therefore is a great boon to some investors while none at all to others. And owing to the fact that under our present law exempted income is *not reported as income at all*, exemption saves the wealthy the very highest rates they would otherwise have to pay, on the amount of their bond investments, as the top portions of their incomes.

Now the demand for bonds by these wealthier income taxpayers would of course be increased by the exemption feature and would tend to raise the price of bonds paying a given nominal rate and thus to lower the resulting rate to the investor. But how much would it do so? That depends on how much of an impetus the exemption gave to the original demand of the wealthy (at the expense of investments in private industry), upon how sensitive those classes not benefited by exemption were to diminished returns, and thus not only on the *extent to which the wealthy displaced the humbler classes* in the government bond market but on the competition they met with in so doing. It is not a question, as some economists have intimated, of the make-up of the bondholding class as regards either the *total* numbers from different income classes comprising it, or the amount of their respective class contributions. It is a question rather of: (1) the number of "*marginal purchasers*" within each income class who are stimulated (or indirectly deterred) by exemption, (2) *their responsiveness* to exemption, as indicated by the increases or decreases in their purchases attending a given change of interest rate, and (3) the *potency* of these sensitive purchasers in the market for non-exempt bonds—i.e., the ratio of their savings to the savings of all purchasers.

By exemption, then, the government would gain the amount of increase in bond prices paid by those not subject to income tax (their number being fewer and total purchases smaller than if there were no bond exemption to increase the competition of the well-to-do). And, if prices went high enough, it might also gain more from the lower class of income-tax payers than it lost by forfeiture of their future taxes, the number of such purchasers being likewise diminished by the increase in price.

On the other hand, it would neither gain nor lose by the purchases of the class whose incomes were of such a size that their

increased price contributions merely offset their future tax exemptions (the number within this class being presumably least affected by the change of method). And it would lose the difference between the sum of price-increases paid by an augmented number of the wealthy and well-to-do and the greater amount of future taxes from which they were freed.

What would be the net result? One man's guess is as good as another's, *provided* both are equally disinterested. The writer would certainly not beg the question, as did Mr. Victor Morawetz,[1] by first guessing that the exemption plan would raise prices enough to reduce interest cost one-eighth (i.e., from 4 per cent with no tax exemptions to $3\frac{1}{2}$ per cent under exemption) and by then arguing that the taxes forfeited would probably not equal that fraction of the interest which must otherwise be paid out under the non-exemption plan. The flaws in this argument seem to be, first, that price-increases probably have a *much more discouraging effect* on those among the humbler classes who would otherwise be bond-buyers than Mr. Morawetz assumes; and hence these increases and the resulting saving of interest to the government are not as substantial as claimed (cf. Professor T. S. Adams' testimony on the experience of private corporations in dropping tax-exempt guaranties).[2] And secondly, the government loses in addition whatever *future increases in income taxes* are not contemplated at the time of bond sale, and so are ineffective (as Professor Seligman has well pointed out) in stimulating the present demand of those benefiting by exemption and in raising their price offers.

To the government therefore there is not the slightest assurance of gain as a motive for relinquishing future taxing rights, and as a deterrent there is the danger of very severe loss in case rates are subsequently raised. For the bondholders, on the other hand, there is certain gain to the very wealthiest, offset by equally certain loss to those among the humbler classes not driven out of the government bond market. The condemnation of exemptions by the economists mentioned is therefore amply justified.

[1] Cf. *New York Times*, April 17, 1917.

[2] Cf. *New Republic*, April 7, 1917, p. 293.

There is, of course, no requirement in the language of the sixteenth amendment for the exemption of state and municipal bonds from tax any more than of federal bonds: "Congress shall have power to lay and collect taxes on income from *whatever source* derived," etc. All that is necessary to such taxation is a court respectful of the ordinary meaning of words as against the alleged self-contradictory intent of their framers.

It is, of course, too late to remove the exemption feature from the Liberty Bonds of June, 1917, but not to remove it from future bonds.

V

What forms of tax should bear the brunt of the burden under the "pay-as-you-go" plan? If the annual cost of American participation in the war and of any aid to the Allies not immediately paid for by them were all paid out of taxation, and if this cost should be so great as to equal the sum of annual pre-war capital accumulation plus wasteful consumption, then the answer would be easy—each major kind of tax hereafter to be mentioned should be "worked to the limit." But this is not the prospect at present (September, 1917).

The question therefore becomes: in which order and to what extent should the revenue possibilities of the various taxes be exhausted? And this is not to be determined by any dictum as to what portion of the war cost should be met by curtailed consumption and what portion by curtailed capital accumulation.

There are two reasons for this. In the first place, all these major federal taxes *curtailed both consumption and private investment*, and the proportions in which they fall upon the two are *quite unknown*. (Cf. the comment on the argument of the National City Bank in Section III preceding.) Banker I. N. Seligman in his June, 1917, report of the Committee on Taxation of the New York Chamber of Commerce said: "Emphasis should further be laid upon taxes on consumption, with a view of conserving for ourselves and our Allies all available resources of raw material and of finished product." If, as seems to be the case, his implication was that such taxes check waste and conserve capital more than severe excess profits and income taxes, then proof of that fact is in order. (This

quotation is typical of thousands of statements in recent financial discussion which sin rather by what they omit and imply than by what they assert.)

But, secondly, even if the exact effect of these several taxes in checking waste or investment were known, the problem of how far to make each contribute toward the total shrinkage desired in either direction would still remain.

Therefore, so long as taxes do not absorb the whole social income above a subsistence level, the resort made to the different taxes must depend on considerations as to the distribution of burdens *between persons rather than between the categories* of waste and investment. This is obviously an ethical issue, toward the solution of which the writer knows no more helpful principle than "equality of sacrifice." He is well aware of the familiar objection that "there is no common denominator or outward measure of men's feelings" and hence no measure of the privation which any given distribution of money burdens will cause them. But an imperfect criterion, incapable of exact and rigid application, is *better than none at all.*

Applying this one, then, we find a very general agreement that sacrifices of the food, clothing, fuel, and shelter necessary to maintain physical vitality are more keenly felt than is the abandonment of the more refined forms of consumption, no matter how imbedded in habit these may be. Likewise inroads upon small savings are as a rule more grievous than proportionate inroads upon the larger surpluses, which generally represent much less privation in the "saving." Therefore the war financier's aim should be to levy upon small incomes and the essential articles of commonest consumption only as a last resort after exhausting the possibilities of all other less burdensome taxes.

VI

The least burdensome of all is the excess-profits tax—when "excess" is properly defined. This involves (1) a definition of "normal" net profits, above which the excess is to be reckoned, and (2) specification of the deductions to be allowed in finding total present profits.

For concerns which have not added considerable new equipment to their plants as they stood in 1911 or 1912 "normal profits" may well be taken as the *average of actual profits* in the three or four years preceding 1915, with the same average allowance for depreciation, whether then correctly reserved or not (otherwise past neglect to deduct depreciation would inflate past profits as a basis for comparison if greater depreciation were deducted from present profits). For concerns which have added considerable new equipment in the past three or four years an arbitrary "normal" income must be imputed to that equipment. This is usually a fixed percentage of its *original cost*.

The chief controversies over deductions to be made in finding present net profits center around the items of depreciation and interest. The original House revenue bill of May, 1917, did not allow deduction of interest on business loans.[1] Nor did it allow for depreciation and obsolescence charges, although in industries using machinery purchased at inflated war-time cost and not adapted to alternative peace uses the latter charge would be considerable. Owing to the uncertainty of our military future, obsolescence charges are also extremely uncertain. The government is best able to assume such risks and should therefore provide all new war-factory equipment (as England has done in part) and lease or operate it as seems best. That would not only vastly simplify the administration of the excess-profits tax, but would remove the only basis for the present demand for low rates, the benefits of which now go to those whose risks are slight as well as to those who risk much. The increase in yields by the imposition of high rates would much more than pay the cost of the factory investments required, the result being great gain for the government.

There is now one other pretext for low rates, namely, that profits are taxed more than once whenever they are paid from one corporation to another (holding company) before distribution to individuals. The House bill of May, 1917, properly corrected this feature of the old law. But the Senate amendment which applies different rates to successive portions of a given excess seems clearly indefensible.[2]

[1] Cf. *New York Times Annalist*, June 4, 1917, p. 750.

[2] Cf. "Losing Our First Trenches," *New Republic*, July 14, 1917, p. 292.

The English rate is now 80 per cent, and the adoption of the foregoing changes would wipe out all valid objections to a 90-per cent or even a 100-per cent rate here—except perhaps as regards the occasional instance of war-time transfers of pre-war equipment at prices much higher than its "normal income" would warrant. Such property might be taxed as new equipment or left to the discretion of an administrative board. But it represents the exception rather than the rule and should be treated as such, by whatever method.

Excess profits under the tax plan would of course be less because of the lesser expansion of bank loans, but still very formidable. The merit of a tax upon them as against the income tax is that the former may be made to *obtain a larger portion* of the excess than would be realized if this were first paid out to stockholders and then partially recovered under a schedule of graduated rates. And a flat 90-per cent or 100-per cent tax would yield several billion dollars per annum under present conditions (the more lenient English tax with a maximum rate last year of 60 per cent yielded \$700,000,000).[1] The yield of slightly over a billion dollars expected from the Senate's September revision of the House bill is, of course, a mere fraction of what could be obtained, but is an improvement upon the recommendation of the Committee of the United States Chamber of Commerce that only \$200,000,000 be taken from this source.

The next least-burdensome levy is the income tax. As regards this the chief controversies center around the rates of supertax and the amounts of exemption allowed.

It may be that revenue needs will compel a reduction of exemption allowances. But in order to equalize the sacrifices of taxation, which are now more grievous to the middle class than to the wealthy, the present and proposed supertax rates should be multiplied *before lowering the exemptions.* To take 95 per cent of the balance of all incomes over \$100,000 and to multiply, say by six, the present rates on lesser incomes would doubtless still leave much revenue to be raised from other sources.

Against such supertaxes all the classic objections noticed in Section III are raised. And in addition Mr. Otto Kahn uses the

[1] Cf. E. R. A. Seligman, "How to Finance the War," *Columbia War Papers.*

indefensible bond-exemption feature of the present law as the ground of another ingenious plea. He claims that the inducement thus offered the wealthy to invest in the Liberty Loan is so great as to require private borrowers to pay 8–10 per cent to equalize the net yield to such lenders, and complains that this will hamper private borrowing.

This of course is only half the story. As was previously seen, the low interest rates incident to tax exemption drive the "marginal" element of small bond-buyers out of the government bond market and into private investment, just as the wealthy are driven the other way. Doubtless these small fry (or the savings banks) will not furnish all the desired private capital at "tolerable" rates, but that cannot be had *at any rate whatever*, if the war is to be efficiently conducted. While Mr. Kahn and others likewise misguided think they are exposing a flaw in progressive taxation, they are really only proving that a nation cannot burn, blow up, and sink its surplus and have it too.

Even with excess profits taxed at 100 per cent the forementioned supertaxes would yield several billion dollars additional, and under a comprehensive system of reporting all disbursements to the government this sum might be collected with slight evasion and very moderate expense. On the other hand, the expense of collection would be multiplied by reducing the exemption allowances, not only because of the greatly increased number of taxpayers, but because, as Professor Seligman remarks, the American middle class comprises a peculiarly large proportion of farmers, a group especially negligent of bookkeeping and "refractory" toward income taxes.[1]

He estimates, moreover, that if the exemption limit were reduced to $1,500 for single men and $2,000 for families, the additional yield would be only $4,000,000–$8,000,000 for each 1 per cent of tax. War needs may justify such a relatively unproductive levy, although not under the supertax rates in existing bills. But there is no warrant for the expectation that the new groups of contributors will take any greatly increased interest in affairs of the federal government. Washington is too remote geographically from the average man, the Hamiltonian structure of government

[1] Cf. *Columbia War Papers*, Series 1, No. 7.

too devious and complicated, and the general feeling of impotence toward it too vivid to remedy by tax doses.

Supertaxes are therefore vastly superior to normal taxes in fiscal productiveness, as well as precedent to them in ethical justification. But however the two are actually adjusted, the greater severity of war rates increases the need for several changes in permanent features of the law. Income should be defined so as to include the rental value of premises used by the owner and of produce consumed on the farm, and so as to allow deductions for losses "outside one's business" and for obsolescence, as well as ordinary depreciation, of property. From the disbursers of dividends and interest the government should require only "information at the source," collecting the tax from the recipients. And there should be an exemption allowance for each dependent child in a family, as well as for the parents.

No increase in the corporation tax is recommended, in order to keep double taxation at a minimum. For the same reason the taxation of the previously taxed income of holding companies should be abandoned. And in order not to put special penalties on the accident of death within the war period, there should be no special tax on inheritances.

Third in the order of choice for war purposes and in yield the writer would put consumption taxes, using that term in the broadest sense. The particular levies should be chosen with a view to conserving the vitality of the masses, to leaving them scope for normal emotional expression (e.g., through family life and cheap amusements), and to making it possible for those who were hitherto small savers to continue saving and keeping "a stake in the country."

To that end the heaviest special taxes should be upon liquors and tobacco, upon pleasure automobiles and automobile accessories (notably tires and gasoline), and upon many of the indulgences of the wealthy, such as jewelry, electric piano players, club dues, opera, and cabaret. Of such taxes those which hit the most people—namely, excises on liquor, tobacco, and oil—were foremost among Civil War sources of revenue, as the list given by Professor Seligman shows. But that list shows no tax on food products, such as was recently proposed for tea, coffee, sugar, and cocoa. An excise

of a cent a pound on domestic sugar would fall primarily on producers well able to stand it, as long as the sugar tariff is retained, and should be imposed as a compensator thereto. But otherwise these food taxes, along with those on transportation, retail light and gas bills, and the cheaper amusements should be utilized only as a last resort.

In the light of the foregoing the Senate proposal of September, 1917, to tax tobacco and liquors $264,000,000 is quite acceptable, and likewise the automobile license tax (to yield $40,000,000) as far as it goes. But a revision which multiplies the former corporation tax while anticipating only $300,000,000 from individual incomes, which rejects the House proposals to tax jewelry, automobile tires, and club dues, and which levies upon transportation (freight, passenger, express, and parcel post) for nearly $160,000,000 is equally to be regretted. There need be no regret, however, that in this latest Senate revision the recommendation of the committee of the United States Chamber of Commerce, to levy $550,000,000 in excises or the equivalent, was not carried out. The moderate levies proposed for excess profits and individual incomes are not sufficient to justify that.

It is true that severe taxes on these latter sources would require a more expert administration than levies on consumption, and a much more extensive and efficient one than the present schedules require. But with the help of such organizing genius as has recently hurried from private life to the aid of other departments in Washington, agencies fully competent to the task might be in smooth working order in the course of the next several months. Professor Seligman's fear that under the "pay-as-you-go" plan the machinery of taxation would break down would then be in no danger of realization.[1]

VII

Another phase of the subject which raises ethical considerations is the share of war costs which the United States is to assume. Obviously this need not be limited to the expense of equipping, transporting, and maintaining our own troops. On the other hand, warrant for so doing might perhaps be found in a study of the

[1] *Columbia War Papers*, Series 1, No. 7, p. 13.

contributions of the Allies to the underlying causes of the present war together with the dubious character of their "terms" as foundations for future peace. Any pronouncement on the international distribution of burdens would be out of place here and is not attempted.

But so long as the United States does actually refuse to give outright to the Allies all that they cannot or will not contribute from their own national incomes toward war costs, the question remains how are they to pay for the supplies we do not contribute free. They can do so only by giving us claims on future income, in the form either of (1) title to specific property represented by private securities, or (2) a general promise to pay such as their government bonds contain. And in either case such claims could be delivered direct to the American capitalist, as the Allies did with the investments of their own capitalists earlier in the war, or to our government as the general representative and guarantor of the American capitalist, as is now being done.

Are both kinds of payment still possible? Within certain limits, yes. French and English capitalists in 1914 held at least $6,000,000,000 of securities issued in the United States alone, of which probably not one-half has as yet been sold here as one means of paying for past purchases. It is true that part of the unsold portion is now "tied up" here as collateral for loans to the Allies, and another part is in American safety vaults as a means of preventing its forced surrender to the Allies' fiscal authorities. But international comity might as easily force surrender of British-held securities in the United States as it threatens to conscript British subjects here, the unpledged securities both here and abroad might be sold here and the proceeds used to pay off the collateral loans, and the collateral so recovered then sold in turn until not a dollar of American securities was owned abroad. Furthermore, there are hundreds of millions, if not billions, of Allied investments in Canada and South America which are so "gilt-edged" that they might likewise find a market in this country and help materially to swell the total of Allied credits here. Probably a total of four or five billion dollars could be realized by such sales of both North and South American securities.

Which kind of payment is preferable, then? The liquidation of foreign holdings in America is preferable because it avoids the danger of repudiation latent in foreign government bonds, which, if it transpired, might force reprisals by the cancellation of foreign titles to United States securities and their distribution pro rata to our capitalists injured by such repudiation. Let no one be deceived as to the seriousness of that danger. As Professor Alvin Johnson remarks, future events are quite possible under which "we might as well prepare to write off to total loss the three billions and the billions we may lend in the future. At any time in the next three decades let war clouds grow heavy over Europe and every income-tax payer in the United States may as well prepare to economize" (i.e., to make good the Allies' permanent default).[1]

Of course a total liquidation of Allied holdings would work an inconvenience, if not a loss, to foreign capitalists as against paying with the "I.O.U.'s" of their respective governments, but tenderness toward foreign capitalists should hardly be the first consideration in American statesmanship. If it is right that the Allies should do more than pay what they can or will out of current income, it is equally and highly expedient that they should do so by relinquishing American securities as long as these last. The war will bequeath future troubles enough without our borrowing any unnecessary ones.

But, after exhausting that source of payment, the Allies might still be debtor to us and have only their government notes and bonds to give in settlement. In the last analysis these must be purchased by our capitalists. The only question is whether our government should assume liability for repaying our capitalists if the Allies "welch" on their obligations later. It is now assuming such liability by borrowing billions to invest in the "I.O.U.'s" of the Allies. If our taxpayers were being compensated for the risk thus thrust upon them and if the liability of each taxpayer in case of Allied default were equitably determined now, then there might be some excuse for this unheard-of exploit in governmental underwriting. But not only is there no such compensation for risk, but in case of repudiation and loss an inequitable distribution among

[1] Cf. *New Republic*, May 5, 1917, p. 12.

taxpayers is almost certain. And the loss would be as much of a surprise to most of them as the risk had been previously unknown.

It is highly desirable therefore that the Allies should borrow any deficits from our capitalists individually. True, that would require payment of interest commensurate with the risk now thrust on the American taxpayer, instead of a rate made abnormally low by exempting government bonds from taxation. But, let us repeat: tenderness toward the foreign taxpayer should not be the first concern in American policy.

It may be urged, however, that the credit of the Allies is now so weak that they could not borrow enough here privately to cover their periodic deficits. If that assertion be proved true by the failure of actual attempts to do so, then the situation calls for either more drastic taxation by them to improve their credit or the outright payment by us of a larger share of the costs of war. But for the reasons already cited that larger share, if accepted, should be raised by current taxation and not by borrowing.

The present plan of loans to the Allies errs, then, in not relying upon taxation for such aid as our government chooses to give them and in not requiring them to finance any remaining deficits with funds obtained direct from our capitalists, through the sale either of private securities acceptable to the latter or of bonds of the Allied governments. As Professor Davenport intimates, our foreign loan is one of the most dubious features of the whole financial plan.

VIII

Reviewing, now, the practical conclusions to which the foregoing argument has led, they may be briefly summarized as follows:

1. Measures which aid the financier indirectly are regulation of private expenditure (e.g., by "rationing" and censorship of capital investment) and stoppage of public improvements. Regulation applied to consumption requires such elaborate administrative machinery as to be practical only as regards the great "staples."

2. Such regulation coupled with control of exports largely obviates the need of price control, which, however, may serve a fiscal purpose in the case of government monopolization of various distributive lines for profit.

3. Except in so far as it is necessary to borrow to cover temporary deficiencies while administrative machinery is being perfected and returns collected, the cost of American participation in the war should be paid only from tax receipts or from government profits in distributive activities.

4. The bonds representing such emergency borrowings should run for a period of not over ten years and should not be exempt from tax.

5. These bonds should be offered at a rate of interest sufficient to secure their purchase by private investors. Commercial banks and trust companies should either be prohibited from buying the bonds of any government and from lending money to individuals for that purpose or should be required to diminish other assets to the same extent as they made such loans.

6. With the definition of "normal" profits and of deductions from current gross profits as above outlined, there should be a flat excess-profits tax at a rate approximating 100 per cent.

7. Under the individual income tax the war rates upon the larger incomes should be multiplied progressively until 95 per cent of all portions of incomes over $100,000 is taken. This should be the prerequisite to a lowering of the exemption limits. The extent of such lowering and of the new "normal" (minimum) rate of tax should depend in turn upon the severity of consumption taxes imposed.

8. The prerequisite to added consumption taxes upon the masses (other than as to liquors and tobacco) should likewise be the drastic taxes specified above, upon excess profits and incomes, and also heavy taxes upon luxuries.

9. Any non-military aid rendered the Allies by our government should take the form of a gift paid out of the proceeds of taxation. If that is not enough, the balance should be obtained from our capitalists individually through the sale either of private securities owned abroad or of bonds of the Allied governments.

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